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SUBJECT: IS CHINA COMPLYING WITH THE G-20 PROMISE ON
"PROTECTIONISM"?

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11. (SBU) SUMMARY: Chinese officials have been quoted broadly both in domestic and international press criticizing "buy American" provisions in the U.S. stimulus package legislation. At the same time, they have pledged that China will not adopt "buy China" provisions and will meet its G-20 Summit pledge of "no new protectionist measures." In reality, however, Chinese law and practice on government procurement mandates procurement of domestic goods and services except in very narrow special circumstances. China also maintains a broad set of industrial and innovation policies designed to promote indigenous technologies, products and industries. In addition, the lack of transparency in Chinese government policies, including the recently announced RMB 4 trillion (USD 596 billion) economic stimulus program, makes it impossible to know to what extent China may impose de facto "buy China" requirements on related procurements, in practice. Finally, a broad range of industry specific adjustments to Chinese tax and other regulations China adopted in recent months, especially with regard to the trade sector, have the effect of promoting domestic goods over imports. In short, China's assertions that it has avoided resort to protectionism in its recent policies, even if true, must be viewed in the context of China's long-standing policy bias toward protecting domestic industries, goods and services, especially in China's state-owned industries. END SUMMARY.

Chinese Officials Criticize "Buy American"
Provisions

12. (SBU) As Secretary Clinton prepares to travel to China just after the new U.S. "Buy American" provision has sparked a wave of criticism from the Chinese press and jibes from the government, a fresh look at the trade/market access environment here is warranted. Certainly, the specter of global protectionism is a frightening one for this export-

dependent economy. Honoring the maxim that the best defense is an offense, Premier Wen Jiabao used the European stage last week to criticize protectionist sentiments and sought to deflect them by promising new Chinese purchases of European equipment and technology. Closer to home, Vice Commerce Minister Jiang Zenwei called a press conference February 9 to announce China "won't practice Buy China", noting "we will treat domestic and foreign products equally as long as they are needed".

13. (SBU) The reality behind the curtain, of course, is not so tidy. Longstanding trade and market access issues naturally tarnish that sought-after free-trading image. Moreover, with this winter's roughly 600 billion USD Chinese stimulus package in the wings, the stakes are growing. A retrospective confined to the period after last November's G-20 Summit Statement, however, would be misleading. China's anti-competitive behaviors long predate the current economic downturn.

Chinese Government Procurement Mandates "Buy China"

14. (SBU) Whatever "new" protectionist measures might be foreshadowed by the Chinese leadership, the 2003 Government Procurement Law (GPL) and associated administrative measures and regulations on the books make it clear there is already a "buy China" policy in effect that applies to nearly all of China's government procurement. While the GPL does have

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some internationally consistent provisions for transparency and challenge mechanisms, public works projects are excluded. This financially vital sector, critical to the stimulus package, is instead covered by what the EU and American Chambers (please protect) in Beijing, respectively, have seen as "a partial and arbitrary application" of the "non-transparent and discriminatory" Bidding and Tendering Law (BTL). It is widely believed that while the BTL does not explicitly require buying from Chinese entities, Chinese government agencies instruct state-owned enterprises (SOEs) to purchase domestic products. Furthermore, according to large US design/construction firm HOK, Chinese tendering firms say stimulus-related projects will require firms that bid to have a Chinese "construction documents license" -- a license which the government has thus far refused to issue to foreign firms. Per HOK, this continues an unfair, but pre-existing, practice that forces it to partner with Chinese firms, driving up costs and lowering quality control.

15. (SBU) Further troubling aspects to government procurement exist. Article 10 of the GPL requires the purchase of domestic goods and services unless they are not available in China, cannot be purchased on reasonable commercial terms, or are for use abroad. In addition, administrative measures adopted in December 2007: a) created significant bureaucratic hurdles to government procurement of those few imported foreign products and technologies that qualify under the 2003 law, and b) restrict government procurement of "innovation" products to Chinese-developed products (Ref A). For example, the AmCham draft 2009 White Paper on Government Procurement (please protect) notes that "certain procurement policies explicitly favor domestic providers and disadvantage foreign providers of energy-efficient or green technologies" including in the wind power sector.

16. (SBU) China is permitted to maintain such discriminatory policies in the area of government

procurement because it is not yet a party to the Agreement on Government Procurement (GPA). Though negotiations continue following its initial offer in December 2007, that offer disappointed on many counts, including its slow timeline (15 years) and extremely limited scope. The EU Chamber goes so far as to say China's offer "neither adhered to previously established GPA norms nor was it made in the true WTO spirit of free trade".

China's Economic Stimulus: The Devil is in the Details

17. (SBU) Many uncertainties linger in the wake of China's leadership's rollout of a 4 trillion RMB (USD 596 billion at current exchange rates) fiscal stimulus plan for 2009-2010 (Ref B) just days before the November 15th G-20 Summit. Confirmed details of its implementation, however, including any potential bidding or tendering processes, are thin. The heavy focus will be on large-scale infrastructure projects, and many provinces and ministries have rushed subsequently to announce over RMB 10 trillion in projects, although these latter projects surely double-count some projects and are not limited to the same two years of the formal central government stimulus plan. Further muddying the waters, the NDRC (National Development and Reform Commission) decision-making in this arena has not been transparent, sector allocations have been shifted at least once, and we believe the figures are still quite fluid. For now, however, the central government stimulus targets a dozen priorities for 2009-2010 spending, including rural infrastructure

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(315 billion RMB), transportation (1.210 trillion RMB), post-disaster reconstruction (700 billion RMB), and health care (600 billion RMB).

18. (SBU) MOF Assistant Minister Zhu Guangyao told Embassies recently that the central government's stimulus plan would focus on five areas: low cost housing, infrastructure projects, disaster zone reconstruction, clean efficient energy and environment, and improving social welfare. There will also be a significant tax relief component focused mainly on business, which has already been announced. Zhu added that these five categories have been decided by the central government and will use funds from both central and local government sources. Localities will be able to tap the proceeds of bonds issued on their behalf by MOF. Local governments have been separately pushing for other types of projects beyond what is in the central government plan, and this has been a subject of keen debate. Zhu added that almost none of the projects under China's stimulus plan will be covered by the GPL which only applies to direct purchases of goods and services by government entities using the fiscal budget. These "projects" will instead be covered by the BTL, which has no "buy China" requirement. Whether foreign businesses will have a shot at competing for these projects and associated contracts remains to be seen, although past practice makes it unlikely, no matter what the current media message is.

Broad Array of Measures to Promote Domestic Goods, Services and Industries

19. (SBU) Even before the global financial crisis (GFC) elicited stimulus packages globally, China turned often in 2008 to tax adjustments to assist domestic export-oriented industries facing slowing

growth, for example through successively increasing export value added tax (VAT) rebates during late 2008 and early 2009. Although perfectly legal under the WTO, such rapid changes in VAT rebates are clearly intended to reverse recent policy moves to shift production away from low value-added exports. Textile export VAT rebates have been raised three times since August 2008. Tax rebates on labor-intensive exports of over 3,000 items were increased in December, also the third such increase in 2008. Beginning this month, import tariffs and VAT on 1,730 tariff lines will be refunded if these items are bound for re-export, lifting restrictions on low-value added exports. Manipulation of export quotas and taxes has also been used in the past to lower domestic prices of needed commodities, or correspondingly increase global ones.

Discriminatory Home-Grown Standards

¶10. (SBU) The PRC's tool basket for encouraging the growth of domestic companies at the expense of foreign business is a full one. One of the less subtle approaches is the creation of domestic standards in a variety of technologies where widely accepted international standards already exist. China relies on this method as a way to encourage "indigenous innovation" and increase domestic patent registration, but also to avoid paying royalty fees to foreign companies that own essential technology. A striking example was the birth by forceps of China's new 3G wireless standard, TD-SCDMA. Though TDSCMA was widely regarded as a technological basket case, the government delayed for years the issuance of 3G licenses to two pre-existing and proven technologies developed in Europe and the United States while it incubated TD-SCDMA. After those licenses were finally issued in all three standards in early 2009, the Chinese government has provided

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an array of policy support and advantages to TD-SCDMA alone. In recent weeks, China has also announced the introduction of the Red-Ray DVD standard, its answer to the global Blu-Ray Disc standard. Another lengthy incubation period is likely. The new emphasis on promoting "indigenous innovation" in the intellectual property rights (IPR) sector prompts concerns over future developments.

Selective Enforcement and Licensing

¶11. (SBU) At times, uneven application of the law or regulations also helps advantage domestic companies over foreign-invested ones. FedEx says it was the only express delivery firm in China against whom China is enforcing a the prohibition on domestic letter mail delivery, and quietly withdrew from this lucrative market in November 2008 in the wake of raids and fines. In the insurance sector, many U.S. firms find that while they may be lucky to get one new branch approved by regulators in the course of a year, domestic competitors wait only a few months at most.

New Anti-Competitive Provisions

¶12. (SBU) At certain times, of course, the gloves come off and the blatancy of protectionism is startling. The express delivery market as it would be affected by the draft new Postal Law (Ref C) is such a case. With an article that expressly prohibits only foreign businesses in the delivery of documents, while allowing private domestic companies in, the law is clearly designed to nurture weak domestic competitors. The fact that the foreign

invested companies excluded employ significant amounts of Chinese nationals, interestingly, seems to have been discounted despite the current economic crisis. These new provisions are to be reviewed again by the National Peoples' Congress (NPC), but their inclusion at a late stage in the State Council Legislative Affairs Office (SCLAO) draft is troubling. Some other measures designed to keep foreign competitors out of domestic markets include: excessively high capitalization requirements for basic telecom operators, pricing policy for medical devices, legal services restrictions, and national champion policies.

Whose Famous Brands Are Being Protected?

¶13. (SBU) China's "Famous Brands" programs present another obvious problem, for which we requested WTO dispute settlement consultations in December. These programs appear designed to promote the development of global Chinese brand names and to increase sales of Chinese-branded merchandise around the world. They are of concern because they appear not only to incorporate export subsidies (which are generally prohibited by applicable WTO rules), but also because of the protectionist industrial policy apparently underlying them.

Intellectual Property and Judicial Interpretation of Concern

¶14. (SBU) These kinds of anti-competitive or protectionist measures are not news. In general, even before the economic downturn it seemed that in many sectors the post- WTO-accession trend toward market opening and liberalization had already reversed. That trend, however, may accelerate under the exigencies of the current situation. One new aspect of particular concern underscores the care with which we will need to approach our bilateral dialogue in this arena. Business and legal contacts in Guangdong have reported that legal resolution of commercial disputes, especially IPR civil cases, has

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measurably weakened as court officials express doubts about enforcing judgments that might cause defendant companies to go out of business and shed local workers (Ref D). If China's economic picture continues to darken, a likely development, we are likely to hear an increasing number of similar anecdotes. As Ref D notes, Guangzhou contacts note lax enforcement of labor, environmental, and other laws that were previously strengthened but now appear to be relaxed whenever a local violator claims they would go out of business if the laws were enforced.

Comment: Chinese Criticism of "Buy American" Disingenuous

¶15. (SBU) COMMENT: Given China's laws on government procurement and its long-standing and vast array of policies that favor domestic goods, services and industries, China's complaint about "buy America" provisions in the U.S. stimulus package legislation must be kept in perspective, especially if those provisions are implemented in a way consistent with U.S. WTO obligations. China's concerted effort to portray, both domestically and internationally, its position otherwise, reflects the Chinese leadership's deep concern that China will suffer disproportionately should protectionist policies become prevalent in response to the globally economic crisis. China's offensive in attacking the "buy American" provisions also is consistent with

the Chinese leadership's strong interest in maintaining a public perception, both domestically and internationally, that the U.S. is to blame for the global economic crisis. Faced with its own severe economic downturn, China's leadership hopes a perception that the U.S. is to blame will help it deflect domestic discontent as China's exports plunge and unemployment levels rise rapidly. END COMMENT.

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